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Business in Brief

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THE CHASE MANHATTAN BANK

Business activity is again approaching the limits set by manpower, materials and plant capacity.

¶ **The number of people at work** has grown by the remarkable figure of 2 million in a year. Unemployment is down to 3.3% of the labor force—below the minimum number usually moving from job to job.

¶ **Steel mills** are running at a rate slightly above theoretical capacity, and new orders are pouring in.

¶ **Auto producers** have scheduled output of 1957 models at a 7 million rate for the rest of the year.

¶ **Exports** ran 25% ahead of a year earlier during the first eight months. Sales to Canada and Western Europe showed the largest increase.

¶ **Retailers** expect a record holiday season and are placing more new orders with manufacturers.

As a result, the industrial production index should soon surpass last December's record of 144.

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The major impetus for expansion continues to come from the investment sector. Businessmen plan to invest in new plant and equipment at a $38 billion rate in the current quarter. That's $6.5 billion (20%) more than the rate a year earlier.

Demand is rising in other sectors, too. Consumer expenditures are on the increase, spurred by higher incomes. And government spending has turned up.

In this situation, there is need for restraint. Fortunately a number of restraining influences are helping to hold demand down to capacity.

¶ **Personal savings** have increased from a rate of $18.8 billion a year ago to an estimated annual rate of $21.5 billion now.

¶ **Business saving** through depreciation and reinvested earnings has risen by about $2 billion.

¶ **The Federal Government** is siphoning off larger amounts in taxation. For the fiscal year the cash surplus will top earlier estimates.

In addition, Federal Reserve policy is helping to contain upward pressures. The tightening in credit markets is designed to hold the expansion in investment down to an amount which can be supported by the increase in savings.

Experience thus far indicates that credit restraint has been a stabilizing influence. It has shifted part of the flow of savings from housing into business investment. It has encouraged a careful review of investment projects. It is helping to maintain high quality standards in credit fields.

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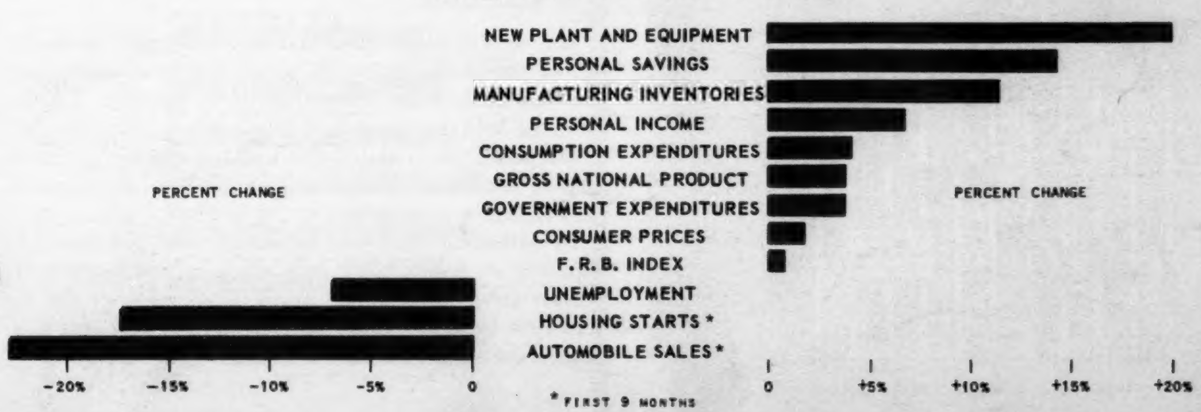
Our economy is again moving ahead rapidly. However, we face new problems in keeping growth balanced and in avoiding excesses. By exercising wise restraint now, we can avoid painful adjustments later on.

THE ECONOMY: NOW VERSUS A YEAR AGO



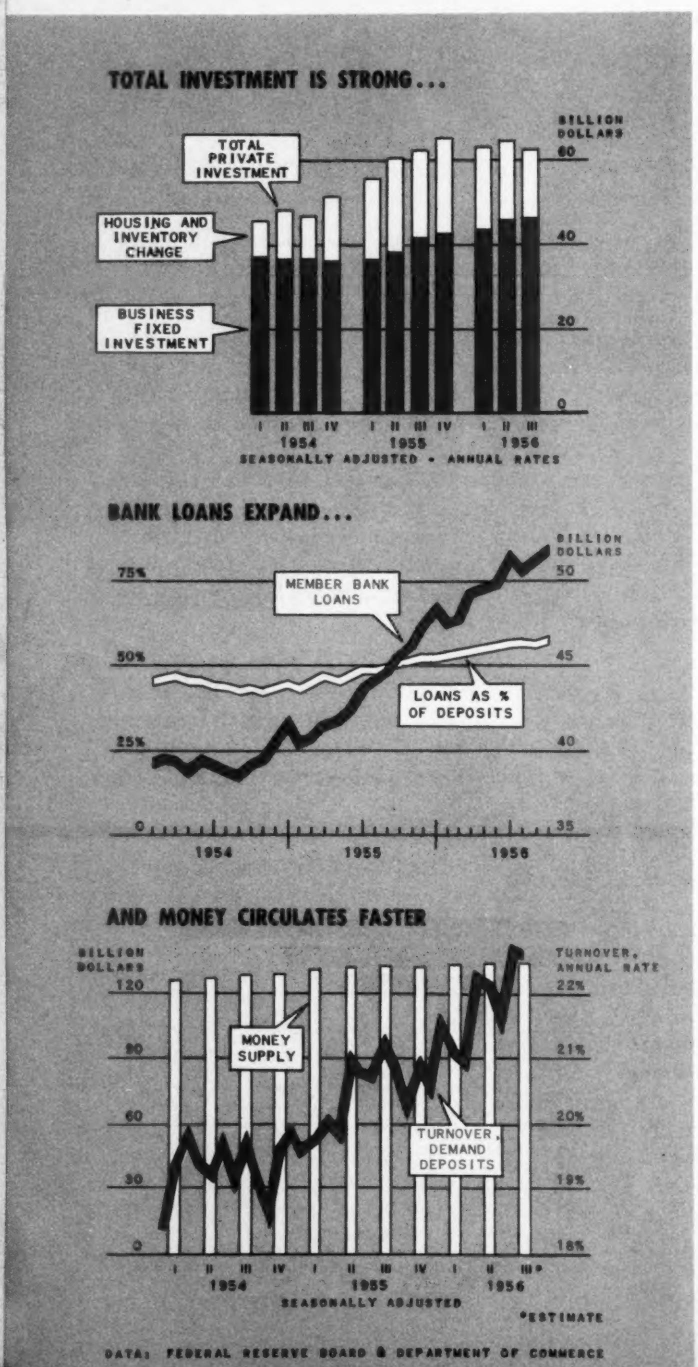
DATA: DEPARTMENT OF COMMERCE, BUREAU OF LABOR STATISTICS AND WARD'S AUTOMOBILE REPORTS

MONEY MARKET

Credit Restraint Reduces Liquidity

For more than eighteen months the Federal Reserve has been pursuing a policy directed toward restraint. Member bank reserves—the credit base of the banking system—have actually been reduced by $928 million. And the rediscount rate has been hiked six times, bringing it to 3%, the highest level in two decades.

How has the policy of credit restraint affected: 1) the money supply and its rate of use, and 2) credit markets generally?



Velocity Increases

The over-all money supply (total deposits and currency) has grown only 1.3% in the past year. In the previous five years it rose at an average rate of 3% per annum.

However, the existing supply of money is being passed from hand to hand at a faster pace. The resulting speed-up in the velocity of circulation actually has much the same effect as an increase in the supply of money.

This does not mean tight credit is having no effect. To the contrary, much of the increase in velocity results in a reduction of liquidity on the part of businesses and financial institutions—that is, a decline in the ready availability of cash, or assets that can quickly be converted into cash without serious loss.

As liquidity declines, business has fewer funds to spare for immediate expansion. At the same time, the ability of financial institutions to increase their loans or investments is reduced.

Corporate Liquidity

In the past two years corporations have expanded their sales by $72 billion, and their current liabilities by $9.6 billion. At the same time, their cash balances plus government securities holdings showed little change.

In this process, corporations have made more efficient use of their cash—its velocity has increased. But corporate liquidity has been reduced in many instances to the minimum limit desired by corporate treasurers.

Changes in Bank Assets

Commercial banks have made great efforts to accommodate their customers by selling large quantities of Government and other securities, many of them at a loss.

- Between the end of 1954 and August 1956, banks that are members of the Federal Reserve reduced their holdings of U. S. Government obligations by some $11.2 billion, largely in the short and intermediate maturity range;

- In the same period they increased their total loans by $15.1 billion.

Just as the economy as a whole has made more efficient use of the supply of money, so the banking system has made more efficient use of its reserves. Excess reserves held by some banks have been borrowed by other banks. As a result, the banking system has been able to expand its total volume of loans and investments on a declining reserve base.

Nevertheless, these developments have reduced the liquidity of banks. The ratio of loans to deposits of weekly reporting member banks increased from 43% in late 1954 to 56% in September of this year. That is the highest ratio since the 1930's.

Moreover, bank holdings of cash, short and intermediate term Governments—a large part of banks' so-called secondary reserves—have declined markedly in the past two years. In all, commercial banks have reached a point where they must be more selective in making additional loans.

Changes in Interest Rates

The most publicized effect of tight money has been to lift the interest rate structure to the highest level in the past quarter century. At the same time, the relationships between yields on different types of investment have changed significantly.

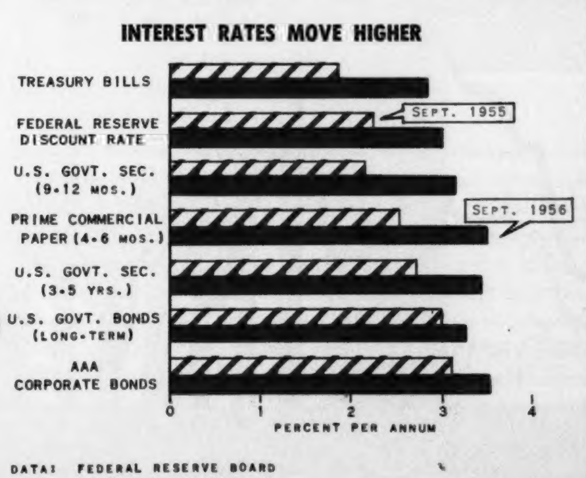
For example, yields on Governments maturing in two to eight years have gone up much more than those on other Governments. The result is a hump in the yield curve of U. S. Government obligations. Recently, it has been possible to receive the same rate of interest on a two year obligation as on a seven year obligation.

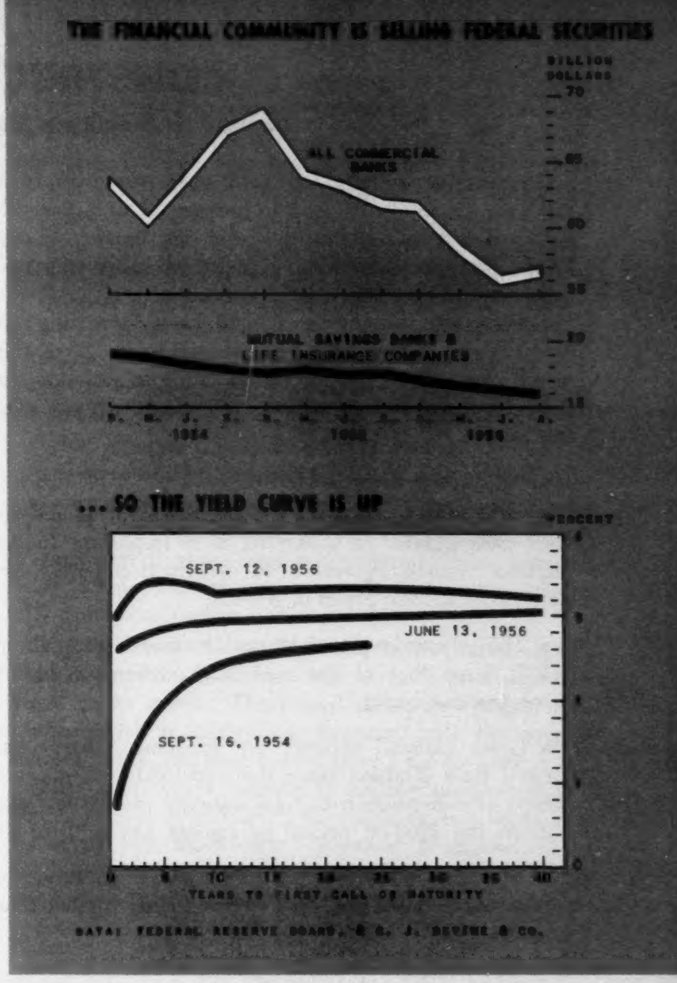
Changes in yield relationships have also set in motion a number of other cross-currents. These affect both the portfolio policies of institutional investors and the money-raising plans of would-be borrowers:

- Mortgage rates have moved higher—to 5% and 5½% for conventional mortgages. However, the rate on VA and FHA mortgages remains fixed at 4½% by the Government. Even though such mortgages are offered at a discount, it is difficult to place them.

- Yields on common stocks have fallen over the past two years, while those on corporate bonds have risen. The yield on Moody's industrials, for example, has recently been 3.91%. Moody's Triple A Corporate Bonds have had an average yield of 3.56%. The narrowing of the gap is inducing some investors to shift from stocks to bonds.

- At the same time, high bond yields have discouraged certain corporate borrowers from entering the capital market. A number of such borrowers have sought temporary accommodation at the banks, but this is becoming increasingly difficult to obtain.





- With common stock prices relatively high, equity financing has continued to be more popular. New common stock issues this year may well match the post-war peak of $2.2 billion in 1955.

Money Management

For close to two years the policy of restraint pursued by the Federal Reserve has forced the economy to use its liquid resources more effectively. In a sense the nation has been carrying forward the process of growing up to the inflated money supply created during the war.

Today the ability of banks and business institutions to reduce their liquidity further is decidedly limited. This tends to make monetary controls exercised by the Federal Reserve more effective. At the same time, it renders the task of the Monetary Authorities increasingly delicate.

More than ever, the Monetary Authorities are faced with the need for measuring accurately the requirements of the economy for additional funds and providing those funds expeditiously. Failure to do so could lead to serious distortions in the money and capital markets, with repercussions spreading throughout the entire economy.

CONSTRUCTION TRENDS

Demand for Building is Strong, But Costs Pose A Problem

Construction activity has held at a very high level this year, despite a 9% drop in housing. The dollar outlay on industrial building is almost 30% above year ago levels; commercial building has posted a 13% gain and utility construction is up 10%.

Construction expenditures have been increasing for twelve years—a long time by past standards. Thus, this would seem to be an appropriate time to examine the strength of the factors underlying the striking rise over this period.

How High Is Present Activity?

As a first step, compare the present level of activity with past trends. In doing so, it is important to use physical volume figures, since construction costs have gone up more than prices in general.

- The physical volume of construction is now about 45% above that of the mid-1920's, when we had a construction boom;

- Gross national product (in constant dollars) has more than doubled since the mid-1920's. Thus, the ratio of construction to total national production was 9% in the 1950-56 period as against 14% in 1923-29.

- Because of the rapid growth in our population, the volume of construction per person is little higher than in the 1920's.

In over-all terms, the significant fact is that the physical volume of building is lower in relation to today's economy than it was in the 1920's when the building boom got out of hand.

A second method of evaluating the construction situation is to look at the factors influencing trends in major areas of the market. The industry builds to meet specific needs—schools, roads, homes, factories, offices.

Backlog Demand

In the post-war period, the industry has faced the dual challenge of making up for the tremendous backlog inherited from the depression and war years and keeping pace with a growing population and economy. The industry's record has been impressive, but there are many areas in which a large backlog remains. Meantime, our rapidly growing economy continues to increase the need for new roads, homes, schools, factories and other forms of construction.

Public Construction

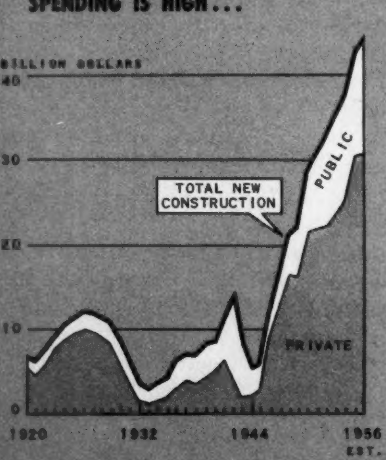
In the field of public construction, total dollar outlays by federal, state and local government have increased four-fold since 1947—a rate of growth surpassing that in other areas. But still we find that our roads, hospitals, schools—our "public assets"—are lagging behind the need for them.

The new Federal Highway Program is designed to bring our road system up to date by 1969. At its peak, total expenditures for highway construction should surpass $8 billion annually.

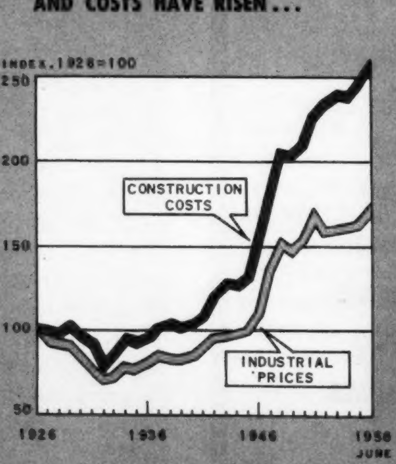
At the same time, the deficit in schools continues to grow. Last year 67,000 school rooms were built. However, experts estimate that we'll require 470,000 new rooms over the next five years; about 210,000 of these represent a backlog needed right now.

Rapid population growth and the shift to the suburbs have placed increasing pressure on the water supply, sewage systems and transportation facilities of many communities. And while our progress in meeting the backlog of housing demands has been spectacular, we have made relatively slow progress in meeting the most difficult problems involved in slum clearance. How to provide adequate housing at reasonable cost in our cities remains a major challenge.

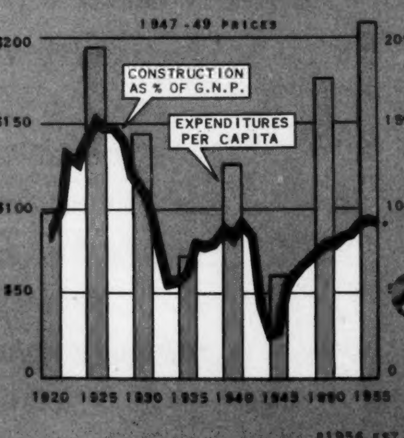
SPENDING IS HIGH...



AND COSTS HAVE RISEN...

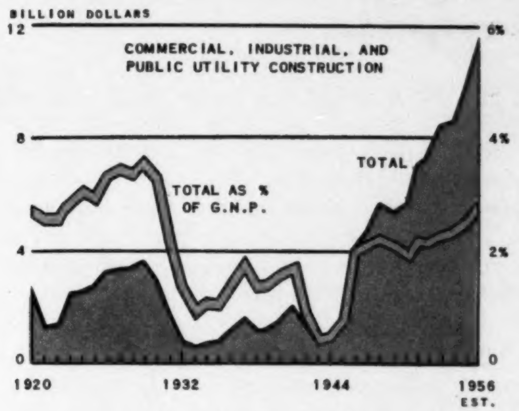


BUT VOLUME SEEMS IN LINE WITH POPULATION AND OUTPUT



DATA: BUREAU OF LABOR STATISTICS & DEPARTMENT OF COMMERCE

BUSINESS CONSTRUCTION IS RISING



DATA: BUREAU OF LABOR STATISTICS & DEPARTMENT OF COMMERCE

Housing

The current slow-down in homebuilding is in considerable part a reflection of the tightening in the mortgage market, following a period of very easy mortgage credit in 1954 and 1955. The annual rate of new housing starts is down from a peak of over 1.4 million early last year to one million now.

However, the underlying factors would seem to support the view that basic demand can be sustained at the present level, or even at a moderately higher level in the next few years:

- The demand for additional housing units arising out of a net increase in family units and other people setting up separate homes is estimated at 700,000 to 800,000 a year.

- The available statistics suggest that we may need to build 300,000 units a year to make up for those torn down or destroyed by fire or flood.

- In addition, the rise in consumer purchasing power, and specifically the amazing rise in the middle income market, means that people can afford better housing than in the past.

These factors do not guarantee a continued high level of homebuilding. But they would seem to offer favorable opportunities to the industry.

Business Construction

One of the characteristics of the post-war period has been a marked emphasis on equipment as opposed to plant in business capital investment. Since 1947 more than 70% of business fixed investment has been in equipment compared to little more than 50% in the 1920's.

The recent sharp rise in industrial building may mark an about-turn in this trend. We may have reached the point where we must build more new factories to house efficiently the machines that are a part of the trend towards automation.

Construction of stores, shopping centers and office buildings has risen sharply in recent years. However, in most areas there are, as yet, few signs of any overbuilding. Even in New York City, where a major share of the new office building has been concentrated, the vacancy rate is 1.4%.

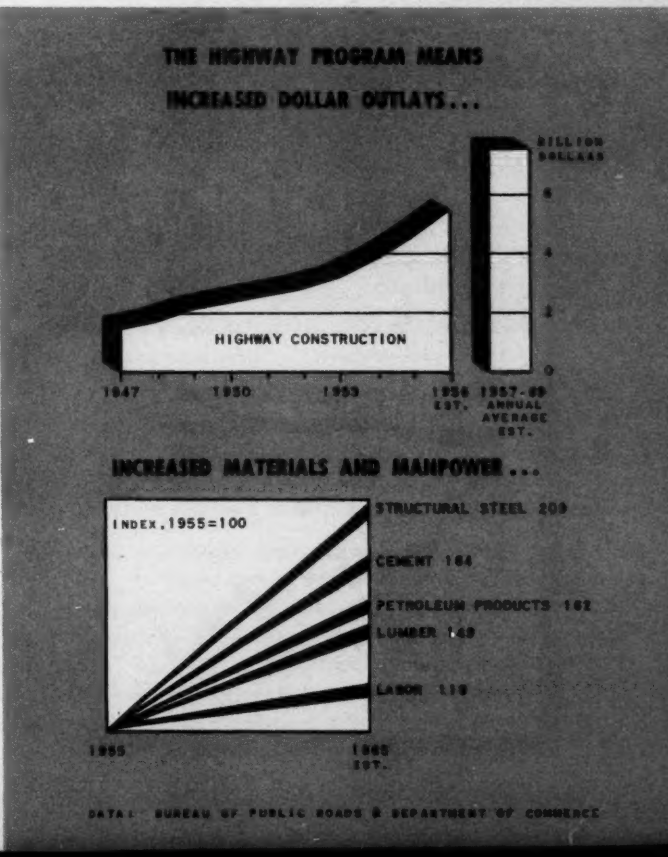
The Problem of Costs

Because of the pressure of demand in all these areas, the construction industry has been operating at virtual capacity since 1945. In this period, construction costs have risen more rapidly than the general average of prices.

What is more, the upward trend in costs seems to be a persistent one—in the past five years construction costs have increased almost twice as fast as the general price level. To be sure, indexes of building costs (which have to be based on wage rates and material prices) may not take full account of improvements in the general efficiency of construction.

The tendency of building costs to rise more rapidly than other prices in recent years seems to be a departure from earlier trends. The record shows that construction costs moved in fairly close harmony with the over-all price level in the long period from 1896 to 1929.

The construction industry is making progress in cost reduction by developing new methods and using new materials and machinery. However, continued efforts in that direction are needed to make it possible for the community to finance the volume of new construction required to support the nation's economic growth.



WAGES AND PRICES

Will Productivity Match the Rise in Wage Rates?

Industrial prices turned up in mid-1955, after four years of relative stability. What part have rising wage rates played in this upward move in an important sector of the price structure? For perspective, it is useful to look at what has happened to wage rates and prices.

Wages Outpace Prices

Experience shows that, over long periods, manufacturing wage rates rise faster than industrial prices. This fact, of course, is one of the important reasons for the long-term rise in living standards.

- In the past four decades, average hourly earnings in manufacturing have multiplied seven times (in dollars not adjusted for changing prices).

- In the same period, industrial prices have multiplied 3½ times.

Increases in productivity (output per man-hour worked) have made it possible for wage rates to rise twice as fast as prices. Thus, output per man-hour in manufacturing about tripled between 1914 and 1955.

Prices and Unit Labor Costs

When you look at the record over shorter periods, the inter-relationship between wages, productivity and prices is equally striking.

- Between 1939 and 1947, wage rates went up 95% while output per man-hour rose only 8%. Thus, unit labor costs increased by 73% and industrial prices moved up 64%.

- In contrast, the rise in productivity matched that in wage rates from mid-1951 to mid-1955. Unit labor costs did not change—and neither did industrial prices.

Since mid-1955 manufacturing wage rates have moved up from $1.87 to $2.00, or 7%. Output per man-hour has shown very little, if any, increase. As a result, industrial prices rose 5% during the past year.

At present, then, we are in a phase where wage rates seem to be outrunning productivity. The hope is that productivity will resume its advance in the period ahead and help dampen the pressure on industrial prices.

Living Costs

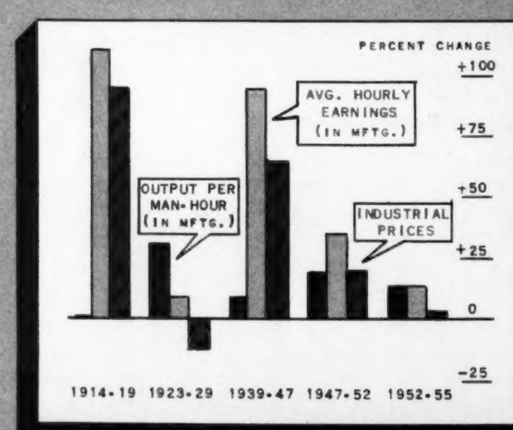
Changes in industrial prices affect only part of the items that go to make up the cost of living index. Actually, food and housing together account for over 60% of the total. Here is how the major items in the index have moved in the past year:

	Per Cent of Total Index	Per Cent Change Since a Year Ago
All Items	100	+2.0
Food	29	+2.0
Meats, Poultry, Fish	6	—3.0
Housing	33	+1.8
Apparel	9	+2.0
Transportation	11	+2.5
Medical Care	5	+4.1

During 1955 a decline in farm prices was the major factor in holding the over-all cost of living steady. The farm price trend reversed this year—farm prices have moved up 9% from their low last December. With both farm and industrial prices rising, the cost of living has increased moderately this year. In over-all terms, the turn-about in the farm price trend emphasizes the importance of raising industrial productivity and keeping wage increases in line with rising output per man-hour.

PRICES TEND TO RISE...

WHEN WAGE RATES GO UP FASTER THAN PRODUCTIVITY



DATA: DEPARTMENT OF LABOR

CONSUMER CREDIT

Consumer credit currently outstanding has reached \$37.5 billion—an all-time high. But the rate of growth which generated an unprecedented rise of over \$6 billion in 1955 has been less rapid in 1956.

- Extensions of new instalment credit in 1956 are averaging about \$3 billion a month—about the same as in 1955.
- But repayments have been rising steadily. The rapid rise of debt in 1955 brought about a corresponding increase in repayments.
- As a result, the total level of consumer credit outstanding has risen \$1.3 billion since last December.

A slowdown was to have been expected after last year's 20% increase. Too fast a rise when the economy is straining at capacity would contribute to inflation and lay the basis for a later letdown.

1955 in Perspective

Although all components of consumer credit rose in 1955, automobile paper registered the sharpest advance —\$4 billion. Two thirds of the 7.4 million cars sold were financed on the instalment plan. Easier credit terms helped achieve this sales record—24 month payments were, in many cases, stretched to 36 months. This year, however, auto sales are down 20%, and the rate of increase in auto debt has slowed.

It remains to be seen how sales of the 1957 auto models will be affected by the high level of debt incurred in the last year and a half. Clearly, many millions of families will still be meeting instalments on earlier models. Even so, 10 million people paid final instalments in 1955, 9¼ million will do so in 1956, and it is estimated that for 1957 the number will be 10¼ million. This latter group, in addition to the many who traditionally purchase for cash, should provide a sizeable sales potential for the new models.

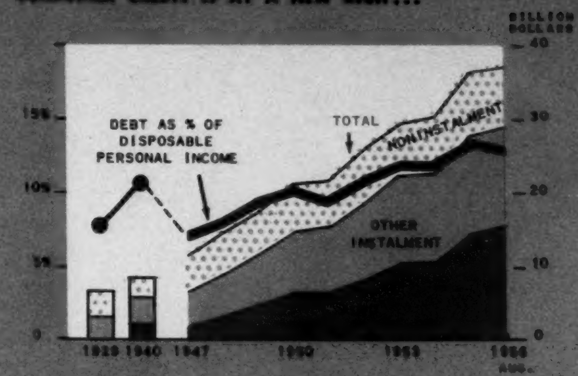
Who are the Debtors?

In analyzing the level and structure of consumer credit it is useful to note the economic characteristics of the debtors themselves. The Federal Reserve Survey of Consumer Finances notes that . . .

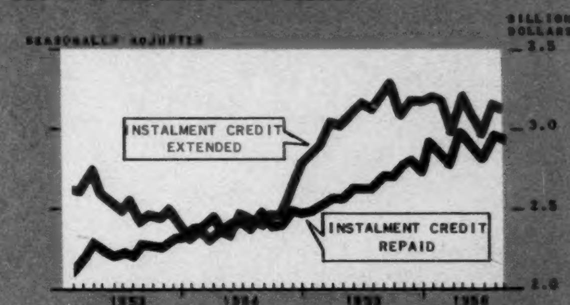
- More than half of all spending units have no instalment debt at all.
- Only 12% of all spending units have fixed payments for instalment credit which require more than 20% of their disposable incomes.
- Income has grown in step with debt. Debt-income ratios have not changed substantially over the past five years.
- Only one-third of the families with incomes under \$3,000 are using instalment credit. Of these more than half owe less than \$200.
- Debt appears to be concentrated in the middle-income groups earning from \$3,000 to \$7,500 annually. Families in this group are typically young and have high aspirations. They use credit as an opportunity to raise their standard of living at an early age.

Significantly enough, the optimism of debtors about the future has been largely borne out thus far—for delinquencies in payments in both 1955 and 1956 have been almost negligible. But maintaining the quality of consumer debt is clearly a vital, continuing responsibility—one which requires caution and restraint on the part of both borrowers and lenders.

CONSUMER CREDIT IS AT A NEW HIGH...



BUT IT IS GROWING MORE SLOWLY



DATA: FEDERAL RESERVE BOARD & DEPARTMENT OF COMMERCE

MOST DEBT IS OWED BY MIDDLE INCOME FAMILIES

Percent of Spending Units in Each Income Class (1955 Income)

Proportion of Disposable Income Used for Instalment Payments	Under \$3000	\$3000-\$7499	Over \$7500	All Classes
None (no debt)	66	46	60	55
Less than 10%	9	19	17	15
10% to 19%	10	20	17	16
More than 20%	14	13	4	12
Not Known	1	2	2	2

Data: Federal Reserve Board

A close look at tight money

Straight talk about banks and small business

Much of what is being written and said today about small business not getting its share of bank credit fails to square with the record.

Banks are doing their level best to meet the credit needs of small businessmen. There is ample evidence of this.

At Chase Manhattan, for example, commercial and instalment loans in amounts ranging from $1,000 to $100,000 made to small business increased 31% in number during the past year.

Current reports from many sections of the country demonstrate that a good percentage of the nation's banks show trends similar to Chase Manhattan's.

This is not to imply that anybody who wants a loan today can walk into a bank and get it.

Money is tight. Right now the demand for credit from banks is bigger than the supply. Borrowers large and small are competing for money. But it's not their size that's really important. What primarily determines whether a business loan will be made is the credit worthiness of the applicant. Bankers are supplying credit to business and commerce for current needs, and figures indicate small businesses are getting their fair share of the money available.

This is the situation today. Back of it there is a simple banking philosophy.

Bankers like to lend money. It's their bread and butter. But sometimes loans have to be turned down. Remember, bankers are not lending their own money. Bank loans are made from money entrusted to banks by depositors. Therefore bankers must use sound judgment and common sense.

This sums up the general position of commercial banks about loans to small business today. We believe it is a sound position . . . one that gives everybody in the business community a fair chance at available bank credit.

THE
CHASE
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